INDEX

CITATIONS

Cases:

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 45

UNITED STATES OF AMERICA, *Petitioner*

v.

HELEN W. BENEDICT and FRANK B. SMITH, as Trustees, and LELAND E. STOWELL and UNITED STATES TRUST COMPANY OF NEW YORK as Successor Trustees under the Will of JOHN E. ANDRUS, DECEASED.

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 4-11) is reported at 81 F. Supp. 717.

JURISDICTION

The judgment of the Court of Claims was entered on January 3, 1949. (R. 11-12). The peti-

tion for a writ of certiorari was filed on March 23, 1949, and was granted on May 2, 1949. (R. 12.) The jurisdiction of this Court rests on 28 U.S.C., Section 1255 (1).

QUESTION PRESENTED

Whether, under Section 162 (a) of the Internal Revenue Code, a trust is entitled to measure its maximum allowable deductions for a gift to charity against the total amount of its long-term capital gains set aside for the charity despite the fact that only one-half of those gains is taken into account as taxable income under Section 117 (a) and (b) of the Code.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations are printed in the Appendix, *infra*, pp. 40-52.

STATEMENT

The special findings of fact of the Court of Claims (R. 5-7) may be summarized as follows:

Respondents are the trustees of a trust[1] created by the will of John E. Andrus, who died on December 26, 1934. The trustees were directed, after paying necessary expenses, to divide the net income of the trust into 100 parts, 55 parts to be paid to certain individuals and 45 parts to the

[1] Under Section 161 of the Internal Revenue Code (Appendix, *infra*, p. 48), a trust is a taxable entity and the tax due from it is to be paid by the fiduciaries. The term "taxpayer", when used herein, will refer to the trust.

Surdna Foundation, Inc., a charitable corporation. Under the terms of the trust, 45 percent of the corpus upon its termination was to go to the Surdna Foundation and 55 percent to named individuals. (R. 5-6.) The Surdna Foundation is a corporation duly organized under the laws of New York exclusively for charitable purposes, payments to which are deductible as contributions under Section 23 (o) of the Internal Revenue Code. (R. 5.) Under the provisions of the trust, 45 percent of the trust income for the fiscal year ended April 30, 1944, the period involved in this suit, was permanently set aside for the Surdna Foundation. (R. 5.)

On the federal income tax return for the trust for the fiscal year ended April 30, 1944, the gross income of the trust, other than gain from sale or disposition of capital assets, was shown as $270,-169.92. The trust had deductions of $29,602.19, leaving a balance of $240,567.73, which was the amount currently distributable to beneficiaries. The trust had a gross long-term capital gain of $60,374.01, of which $30,187.01 was taken into account in computing taxable net income. This amount of $30,187.01 was reduced by a 1942 carry-over of $329.60, leaving a taxable balance of $29,857.41. On the fiduciary return, the trustees deducted $13,435.83 (45 percent of $29,857.41), which represented Surdna Foundation's portion of such amount. This left the amount of $16,421.58 which was reported on the return as "Net Taxable

Gain Taxable to Trustee." There was actually set aside for Surdna Foundation 45 percent of the $60,374.01, or $27,168.31. (R. 6.)

The trustees filed a timely claim for refund in which the amount of $27,168.31 was claimed as a deduction on the ground that in computing the net income of the trust, 45 per cent of the total capital gains realized, instead of 45 per cent of the amount of $29,857.41, should have been deducted. The claim had not been acted on by the Commissioner of Internal Revenue when this suit for refund was commenced. (R. 6-7.)

On the foregoing findings of fact, the Court of Claims, one judge dissenting, held that the trust was entitled to deduct $27,168.31, which is 45 per cent of the total capital gain of $60,374.01, and rendered judgment accordingly in favor of the trustees. (R. 7-11.)

SPECIFICATION OF ERROR TO BE URGED

The Court of Claims erred in failing to hold that the trust is entitled to deduct only the taxable portion of the capital gain set aside for Surdna Foundation.

SUMMARY OF ARGUMENT

The trust in this case actually received a capital gain of about $60,000, and only some $27,000 of that amount was set aside for charitable purposes, the remainder being available for non-charitable beneficiaries. Yet, the Court of Claims has held

that less than $3,000 is taxable. A careful analysis of the statute discloses that no such bizarre result is required. The decision of the Court of Claims is inconsistent with the legislative history as well as with the uniform administrative practice. The contrary result was correctly reached by the Court of Appeals for the Second Circuit.

A. Section 162 (a) of the Code authorizes a trust to deduct any part of its "gross income", without limitation, which pursuant to the terms of the will is permanently set aside for charity. It has been held that the term "gross income" in this statute means gross income of the trust under Section 22 (a) of the Code. In the case of the long-term capital gain here, the amount "taken into account" in computing net income under Section 117 (b), that is, 50 per cent thereof, is the gross income from the gain for purposes of Section 22 (a). If this were not so, and the entire long-term capital gain constituted gross income under Section 22 (a), one would expect to find some provision in the Code under which the non-taxable portion of the gain is deductible or excludible. But there is no such provision and, it follows, necessarily, that only that part of the gain taken into account under Section 117 (b) is to be included in gross income. This is confirmed by the definition provision of Secuion 117 (a), to the effect that capital gain for tax purposes is the gain on sale or exchange of a capital asset to the

extent the gain is taken into account. When, as in the case of long-term capital gains, only 50 per cent is taken into account, that 50 per cent and no more is the "gain" which is includible in "gross income" under Section 22 (a).

The legislative history of Section 117 confirms that it was the intention of Congress, in enacting the statutory provisions just discussed, that only the percentage of capital gain taken into account in computing net income was to constitute gross income.

Section 117 has been so interpreted administratively consistently from the Revenue Act of 1934 when the system of taking only a percentage of the gain into account according to the period the asset had been held was inaugurated. On the tax return forms issued for 1934 and for each year since, the computation of the entire gain is required to be shown in a schedule, but only the percentage to be taken into account is carried forward and included in the items of gross income. This administrative construction has received the approval of Congress since the statutory provisions have been reenacted several times without significant change.

Finally, *Commissioner* v. *Central Hanover B. & T. Co.*, 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom. Trust of Andrus* v. *Commissioner,* 332 U.S. 830, held, in square conflict with the decision in this case, that only the percentage of gain taken into account in computing net income

represents gross income under Section 22 (a). The other pertinent cases are consistent with this holding.

B. In any event, the term "gross income" in Section 162 (a) should not be construed so as to allow a deduction of the nontaxable portion of the capital gain set aside for charity. The purpose of Section 162 (a), which was to encourage charitable gifts by exempting them from income tax, is served if that portion of the capital gain given to charity is relieved of tax. At the same time, the intention of Congress, expressed in Sections 161 and 162 (b) and (c), that the part of the gain, to the extent it is taxable income, held for other beneficiaries, shall be taxed, is carried out. This would not be true if the trust is permitted to compute the deduction in such manner as to exempt from tax a part of the gain held for private beneficiaries which was meant to be taxable to the trust. A further reason for construing the statutory provision to measure the trust's deduction by the taxable part of the gain set aside for charity is that it is necessary to do so in order to prevent the equivalent of a double deduction which would otherwise arise through the exclusion from taxable income of one-half of the gain given to charity and the deduction from other income (that held for individual noncharitable beneficiaries) of the entire gain so set aside, including the one-half of the gain already excluded from income. A construction of Section 162 (a) which

will not permit the equivalent of a double deduction would be especially consonant with Congressional policy as exhibited in Section 24 (a) (5) of the Internal Revenue Code, which prohibits the deduction "in any case" of an amount, otherwise allowable as a deduction, which is allocable to income wholly exempt from income tax.

C. Since only half of the capital gain was "taken into account" and therefore constituted "gross income" either under Section 22 (a) or Section 162 (a), the trust's allowable deduction under the precise words of Section 162 (a) consists of the part (45 per cent) of this half of the gain which was set aside for Surdna Foundation. This gives a deduction for the part of the "gross income, without limitation" which was set aside for charity. The words "without limitation" in Section 162 (a) were intended, and operate, only to remove in the case of trusts and estates the 15 per cent of net income limitation which applies to the deduction of charitable contributions by individuals.

ARGUMENT

The Trust's Allowable Deduction Under Section 162 (a) of the Internal Revenue Code in Respect of Its Income From Capital Gains Is the Taxable Portion of the Gain Set Aside for Charity

Section 162 (a) of the Internal Revenue Code (Appendix, *infra*, pp. 48-49) allows to trusts a deduction, in lieu of the deduction for charitable

contributions authorized for individuals by Section 23 (o), of

> any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside

for charitable purposes. There being no dispute as to the right of the trust in this case to deduct the amount of its ordinary income which was set aside for the Surdna Foundation,[2] the only question is the proper measurement of its deduction in respect of its income from capital gains.

The trust realized during 1944 a capital gain of $60,374.01[3] but, because the capital assets disposed

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[2] The ordinary net income of $240,567.73 was all currently distributable to beneficiaries and the 55 percent thereof payable to individuals was therefore available as a deduction to the trust under Section 162 (b) of the Internal Revenue Code, which allows a deduction to a trust of the income for the taxable year which is to be distributed currently to beneficiaries, provided that the amount allowed as a deduction is included in computing the net income of the beneficiaries, whether distributed to them or not. The 45 percent of the $240,567.73 which was set aside for Surdna Foundation was allowable as a deduction to the trust under Section 162 (a), rather than Section 162 (b). See *Grey* v. *Commissioner*, 41 B. T. A. 234, affirmed, 118 F. 2d 153 (C. A. 7th).

[3] The capital gain was evidently not considered as currently distributable income but as an addition to corpus for purposes of administering the trust. Cf. *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509; *In re Rogers' Estate*, 143 F. 2d 695, 696 (C. A. 2d), certiorari denied, 323 U. S. 780. Because the 55 percent of the gain which ultimately will be distributed to individuals on termination of the trust was not currently dis-

of had been held for more than six months, only one-half, or $30,187.01, was to be taken into account under Section 117 (b) of the Internal Revenue Code (Appendix, *infra,* p. 46) in computing taxable net income. This gross figure was reduced by a 1942 carry-over of $329.60,[4] leaving a balance of $29,857.41 which was taken into account as income. There was permanently set aside for the Foundation 45 percent of the total

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tributed or distributable, the trust was not entitled to a deduction under Section 162 (b) or (c) in respect of it. Since 45 percent of the gain was permanently set aside to be distributed ultimately to charity, the trust may however have a deduction in some amount in respect of it under Section 162 (a). See G. C. M. 423, V-2 Cum. Bull. 53 (1926); G. C. M. 10423, XI-2 Cum. Bull. 127 (1932); cf. *Bowers* v. *Slocum,* 20 F. 2d 350 (C. A. 2d). The question here presented, whether the deduction may be of the total capital gain or only the taxable portion thereof set aside for charity, did not arise in the cited authorities because they involved taxable years occurring prior to the enactment of the Revenue Act of 1934, c. 277, 48 Stat. 680, which inaugurated the system of taxing only a percentage of the capital gain depending on the length of time the asset disposed of had been held. See infra, pp. 19-21. The findings in *Commissioner* v. *F. G. Bonfils Trust,* 115 F. 2d 788 (C. A. 10th), affirming 40 B. T. A. 1085 (see also *Bonfils, Exrs.* v. *Commissioner,* 40 B. T. A. 1079), do not show whether the question in this case may have been present there, but if it did lurk in the case it was not raised or decided.

[4] The trust's 1944 return, which was an exhibit in the case before the Court of Claims, showed that this was a capital loss carried over from 1942. Section 117 (e) of the Internal Revenue Code (Appendix, *infra,* pp. 47-48) authorizes the carry-over of a capital loss for one year to reduce the capital gains of succeeding years in some circumstances.

capital gain of $60,374.01, or $27,168.31, and the Court of Claims held that under Section 162 (a) the taxpayer is entitled to deduct the full amount of $27,168.31 set aside.

It is the Government's position that this decision is erroneous and that the trust is entitled, under Section 162 (a), to deduct only that part of the capital gain permanently set aside for Surdna Foundation which constituted taxable income. This view makes full allowance taxwise for monies set aside by the trust for charitable purposes since one-half of the amount in question is excluded from gross income leaving only the other half to be deducted under Section 162(a). Here, the trusts allowable deduction under Section 162(a) would be $13,435.83, representing 45 percent of the taxable capital gain of $29,857.41. In support of this position, we shall show (A) that only 50 percent of the capital gain constituted "gross income" within the meaning of Section 22 (a) of the Internal Revenue Code; (B) that only that part of the gain, in any event, constituted gross income for purposes of Section 162 (a); and (C) that the trust's allowable deduction under Section 162 (a) is 45 per cent of the taxable portion of the capital gain.

A. Only the taxable portion of a capital gain constitutes gross income under Section 22(a)

1. *The statutory provisions.*—It has been held that in allowing a deduction for the part of the "gross income" which, pursuant to the terms of

the will, is permanently set aside for charity, Section 162 (a) refers to the statutory gross income for tax purposes, or gross income within the purport of Section 22 (a) of the Code. The Court of Claims so thought in this case (R. 8), and this view accords with that of other courts. *Commissioner* v. *Central Hanover B. & T. Co.,* 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom. Trust of Andrus* v. *Commissioner,* 332 U.S. 830; *Frank Trust of 1931* v. *Commissioner,* 145 F. 2d 411 (C.A. 3d). For present purposes, it will be assumed that gross income under Sections 22 (a) and 162 (a) is the same.

Section 22 (a) of the Code (Appendix, *infra,* p. 40) includes in gross income *inter alia* gains from dealings in property, but it does not specify how the gain from sale or other disposition of property which is includible in gross income shall be determined or measured. Hence it is obvious that Section 22 (a) alone is not a complete definition in so far as such gains are concerned and that other sections must be examined to determine the gain which will constitute gross income. Indeed, Section 22 (f) (Appendix, *infra,* p. 40) provides that in the case of a sale or other disposition of property, the gain or loss shall be computed as provided in Section 111.

Section 111 (a) of the Code (Appendix, *infra,* p. 43) provides that the gain from sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted

basis provided in Section 113 (b), and Section 111 (c) (Appendix, *infra,* pp. 43-44) provides that the extent to which a gain so determined shall be recognized shall be determined under the provisions of Section 112. Where a gain is not recognized under Section 112, it does not constitute "gross income" under Section 22 (a). 3 Mertens, *Law of Federal Income Taxation,* Sec. 20.01, p. 81. And this is so, even though it is a "gain" as computed under Section 111.

Sections 111 and 112 deal generally with all types of gains and losses, ordinary as well as capital, but they are not complete in so far as capital gains and losses are concerned. In the case of capital assets, after the excess of the amount realized over the adjusted basis has been determined under Section 111 and the gain so determined has been ascertained to be a recognized gain under Section 112, it is still necessary to look to Section 117 to find the portion of the capital gain which is to be "taken into account" and so is the ultimate measure of gross income includible under Section 22 (a).

Section 117 (b) provides that only 50 percent of the gain or loss on sale or exchange of a capital asset shall be taken into account in computing "net" income if the capital asset has been held for more than six months.[5] This section does not

[5] All of the capital gain ($60,374.01) involved in this case was derived from the sale of assets which had been held for more than six months. (R. 8.)

explicitly point to the effect on gross income of its provisions, but an analysis of the general plan of the Code makes it clear that capital gains, not taken into account under Section 117 (b), cannot be included in gross income.

Under Section 21 (a) of the Code (Appendix, *infra*, p. 40) "net income" means the gross income computed under Section 22, less the deductions allowed by Section 23. If, as the Court of Claims held, the entire long-term capital gain constitutes gross income under Section 22 (a), then there should be found some provision in the statute under which the nontaxable portion of the gain is deductible or excludible. But Section 23 contains nothing to authorize a deduction for the part of a capital gain which is not to be taken into account. Section 117 (b) does not itself purport to grant a deduction from gross income. And although Sections 22 (b) and 116 enumerate items which are to be excluded from gross income, neither makes any mention of capital gains. As a result, unless the part of the gain not taken into account pursuant to Section 117 (b) is regarded as excluded from gross income by that section, the computation of net income as provided in Section

21 (a), which Section 117 (b) plainly refers to, would not eliminate the nontaxable capital gain. The only way in which net income can be computed under the statutory plan of Sections 21, 22, and 23, to reflect only the 50 percent of the long-term capital gain to be taken into account, is to include only that 50 percent in gross income.

Section 117 (b) does not itself direct how the net income of a taxpayer is to be calculated. It prescribes only that specified percentages of gain or loss are to be taken into account "in computing net income." The necessary conclusion is that net income is to be computed as provided in Sections 21-23, already discussed, and that Section 117(b) was not intended to oust or replace Sec-

tions 21-23. Cf. *White* v. *United States,* 305 U. S. 281, where it was pointed out (pp. 286-287) that the capital gains and loss section (101) of the Revenue Act of 1928 was supplementary[6] to Sections 21, 22, and 23, which governed the computation of net income. The view that Section 117 (b) was intended to fit into the plan for computation of net income in Sections 21-23 is further emphasized by the fact that while Section 23 contains no provision for deducting the portion of gain not taken into account, Section 23 (g)(1) (Appendix, *infra,* p. 41) provides that capital losses are to be deducted "only to the extent provided in section 117." Section 23 (g)(1) is thus the specific authority for deduction of a capital loss, not Section 117 (b). Section 23 (g) (1) would be superfluous if Section 117 (b) itself authorized deduction of a capital loss in computing net income. Such redundancy is not to be implied.

Thus, it is evident that Section 117 (b) fits precisely into the pattern of Sections 21-23. Where there is a gain, there is no need for an exclusion or deduction since the portion not taken into account is never reflected in gross income. But where there is a capital loss, a specific authority for deduction of the loss, as found in Section 23 (g)(1), is necessary in order that net income may

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[6] Section 117 (b) of the Code is still supplementary. It is contained in Supplement B to Chapter 1, imposing the income tax, of which Sections 21-23 are a part.

be reduced. That is to say, the mandate of Section 117 (b), that only specified percentages of a capital gain or loss "shall be taken into account in computing * * * net income" is followed when capital gains are taken into account by including them *in* gross income, and capital losses are taken into account by deducting them *from* gross income after it has been computed.

It is no answer to this analysis that Congress, in Section 117 (b), used the phrase "net income" and not "gross income". For Congress, in that section, was dealing not only with gains but also with losses; and a loss is not taken into account, as has been shown, in the computation of gross income. Congress chose to deal with both gains and losses together in Section 117 (b), and the language used must be appraised in that light. Its precise and necessary meaning in respect of gains alone appears by consideration of the fact that, "in computing * * * net income", gains can be taken into account only by including them in gross income. It must follow, we submit, that only 50 percent of a long-term capital gain represents gross income under the language of Section 117 (b).

The correctness of this conclusion is underlined by the fact that Section 22 (a) defines gross income as including "gains * * * derived from * * * sales, or dealings in property", and Section 117 (a) (4) states that—

> The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income:[7]

By Congressional direction, therefore, a taxpayer is regarded as having a capital gain for tax purposes only to the extent it is "taken into account" in computing net income. The effect of this definition is to permit a taxpayer to ignore the portion of the gain not taken into account and thus not to treat it as gross income within the purview of Section 22 (a). It should be noted that the definitions are stated to be for use in the whole income tax chapter, not merely Section 117.

Finally, Section 117 (c) (2) of the Code (Appendix, *infra*, p. 47) provides, in certain circumstances, for a tax in lieu of the ordinary normal tax and surtax.[8] This alternative method may be used only if it results in a lesser tax than would otherwise result and, it follows, that the two taxes must be computed on the same base, that is,

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[7] Similar definitions are found in Section 117 (a)(2), (3), and (5) for short-term capital gain, short-term capital loss, and long-term capital loss.

[8] The normal tax and surtax is imposed by Sections 11 and 12. Under those sections the net gain to be taken into account is included in gross income along with other items of taxable income, the allowable deductions are subtracted therefrom to arrive at net income, and the normal tax and surtax imposed by Sections 11 and 12 on individuals are computed on the net income so determined.

on the same income. It is quite significant, then, that the alternative method prescribed includes in income only such capital gains as are "taken into account" under Section 117 (b). It does so in this fashion: A partial tax on the net income, reduced by the excess of the "net long-term capital gain" over the "net short-term capital loss" is first computed at the rates provided in Sections 11 and 12. There is then added to this partial tax a tax of 50 percent of the excess. The amount of this excess is determined by reference to the definition provisions of Section 117 (a) (Appendix, *infra*, ~~pp. 44-46~~), and these, in turn, limit capital gains and losses to the amount "taken into account in computing net income." See Sections 117 (a) (2)-(5). In the case of a long-term capital gain, the amount taken into account, as we have seen, is only 50 per centum. Section 117 (b), Appendix, *infra*, p. 46). Thus, 50 per cent of the long-term gain is all that ever enters into the computation of the alternative tax and there is no reason whatever to believe that a greater amount is included in gross income when the tax is computed under Sections 11 and 12.

2. *The legislative history.*—The legislative history of Section 117 confirms the conclusion that a taxpayer's gross income includes only the portion of a capital gain which is taken into account. Although capital gains and losses have been specially treated since the Revenue Act of 1921, the system

of taxing capital gains and losses by taking only a specified portion of the gain or loss into account, depending on the length of time the asset had been held, dates from the adoption of Section 117 of the Revenue Act of 1934, c. 277, 48 Stat. 680.[9] In explaining the new provision, H. Rep. No. 704, 73d Cong., 2d Sess., p. 10 (1939-1 Cum. Bull. (Part 2) 554, 562), stated:

> First. To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes: * * *

This shows, we believe, that it was intended that the measure of the gain realized was to be the percentage of gain taken into account. In other words, for tax purposes, statutory gain under Section 22 (a) consisted of the portion of the actual gain taken into account. This intention is made even clearer in the same committee report. After giving a specific example in which the capital gains were $8,000, the capital losses were $7,000, and the capital gains and losses to be taken into account under the percentages then applicable were $7,600 and $4,400, respectively, H. Rep. No. 704, *supra*,

[9] The percentages and the holding periods have not remained the same in the various Revenue Acts since that Act and in the Internal Revenue Code, but the method of taxing a percentage of capital gains and losses according to the period held has not been changed.

pp. 31-32 (1939-1 Cum. Bull. (Part 2) 554, 578), stated:

> In the above case, the *taxpayer would include in gross income subject to tax* $7,600 in gains and be allowed to deduct $4,400 of losses. The net increase in his income will, therefore, be $3,200. * * * (Italics supplied.)

Thus, it is apparent that the Committee intended that gross income would include only the portion of the total gain which was taken into account under Section 117.[10] And ten years later, in recommending a technical amendment to Section 117 to conform it to the new definition of "adjusted gross income" in the bill which became the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231, Sec. 8, the Senate Finance Committee stated (S. Rep. No. 885, 78th Cong., 2d Sess., p. 26 (1944 Cum. Bull. 858, 879)):

> Of course, the same percentages of gain or loss taken into account in computing net income under section 117 (b) *are taken into account in determining gross income,* and, therefore, in computing adjusted gross income. (Italics supplied.)

3. *The administrative construction.*—The administrative construction of the statute, as re-

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[10] S. Rep. No. 558, 73d Cong., 2d Sess., pp. 11-13 (1939-1 Cum. Bull. (Part 2) 586, 594-596), indicates no disagreement with this basic understanding of the legislation.

flected in the tax return forms,[11] has been in accord with the interpretation here urged. The fiduciary return of the sort filed by the taxpayer in this case (bound in at the back of this brief) provides, in Schedule E, for the reporting of the following data for assets held for more than six months: A description of the property, the date acquired, the date sold, the gross sales price, the basis, the expense of sale, the depreciation theretofore allowed, and the resulting gain or loss. Fifty percent of the gain or loss so determined is then entered in column 10 which is designated the net long-term capital gain or loss. The net long-term gain (less a capital loss carry-over if any) shown in Schedule E is carried over and entered as item 7 (a) on page one of the return under the heading "income." From the total income, amounts are subtracted pursuant to the various deductions allowed by law, and the net income is thus arrived at. On the return form actually used and followed by the taxpayer in reporting the gain involved in this case, therefore, although the total gain was computed in a schedule, attached to the return, only the 50 percent of long-term capital gain taken into account under Section 117 (b) was

[11] Section 29.117-2(a) of Treasury Regulations 111 (Appendix, *infra*, pp. 51-52) merely repeats the statutory language and is not presently helpful. However, the first example contained in Section 29.162-2 of Treasury Regulations III shows very clearly the Treasury interpretation of the statute, namely, that the percentage of long-term capital gain which is not to be taken into account under Section 117(b) is an item which is not includible in gross income.

included as an item of taxable gross income. The return forms for both individuals and estates and trusts from 1934[12] up to and including the year 1943-1944 which is in issue here, and indeed even to the present time, have consistently required the inclusion in taxable gross income of only the percentage of capital gain taken into account. See return forms printed in C.C.H. and P-H Federal Tax Services.[13] See also *Maloy* v. *Commissioner*, 45 B.T.A. 1104, 1107, in which the Board of Tax Appeals (now the Tax Court) referred to the fact that, on the return form for 1935, only the part of the capital gain taken into account under Section 117 (b) was treated as gross income.

The administrative position was also stated in 1939 in G.C.M. 21432, 1939-2 Cum. Bull. 234, which considered the proper computation of the foreign tax credit allowed by Section 131 of the Revenue Act of 1934 in connection with a capital gain. The

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[12] As was pointed out, *supra*, pp. 19-20, the system of taxing only a part of the capital gain, depending on the length of time the asset disposed of had been held, originated in the Revenue Act of 1934.

[13] C. C. H. Federal Tax Service for 1935, pp. 16113-16114, 16133-16134; 1936, pp. 16096-16097, 16102-16103; 1937, pp. 16091-16092, 16097-16098; 1938, pp. 16110-16113, 16122-16123; 1939, pp. 228-231, 16060-16062; 1940, pp. 16070-16073, 16088-16091; 1941, pp. 16035-16038, 16053-16056; 1942, pp. 16031-16034, 16049-16052; 1943, pp. 16031-16034, 16054-16057.

The return forms have consistently so treated capital gains even down to the present time. See P-H Federal Tax Service for 1945, pp. 18763-18766, 18794-18797 (1944 returns), 18841-18848, 18861 (1945 returns); 1947, pp. 18785-18789, 18795-18798 (1946 returns); 1948, pp. 18785-18789, 18800-18803 (1947 returns); and 1949, pp. 18810-18819 (1948 returns).

entire gain was taxed by the foreign government, but only a percentage thereof (30 percent) by the United States. In limiting the credit to an amount computed on the taxable portion of the gain, the ruling stated (p. 236):

> From the foregoing precedents, it is evident that under the Revenue Act of 1934 if the income taken into account under section 117 (a) is limited to 30 per cent of the actual income, the remaining 70 per cent of the profit from the transaction *is excluded entirely from gross income* and, therefore, forms no part of the net income upon which the United States tax is computed. * * * (Italics supplied.)[14]

The administrative construction of Section 117 (b), as reflected consistently for almost ten years prior to the taxpayer's fiscal year, and since that time, in the widely distributed and public tax return forms, has, under well established principles, received the implied approval of Congress, since the statute was reenacted and amended several times during the interval without significant change in this respect. *Crane* v. *Commissioner,* 331 U.S. 1; *Helvering* v. *Wilshire Oil Co.,* 308 U.S. 90; *Helvering* v. *Winmill,* 305 U.S. 79. See *Estate of Sanford* v. *Commissioner,* 308 U.S. 39, 52-54, rehearing denied, 308 U.S. 637; *Helvering* v. *Bliss,* 293 U.S. 144; cf. *Brewster* v. *Gage,* 280 U.S. 327.

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[14] G.C.M. 21432 was modified by G.C.M. 25723, 1948-2 Cum. Bull. 131, in so far as the method of computing the foreign tax credit is concerned, but the statement quoted above was not modified or withdrawn.

It seems indisputable that the administrative practice in this regard carries out the intention of Congress, as expressed in Section 117 (a) and (b) and the legislative statement already discussed. But if, contrary to our firm conviction, Section 117 (b) were regarded as not entirely clear on the question of whether the capital gain taken into account is to be the measure of gross income or only of net income, the administrative interpretation which has implied legislative approval should be controlling. This is especially true here, because in Section 117 (a) of the Revenue Act of 1938, Congress enacted the definitions of long and short-term capital gains and losses, which are in harmony with the administrative construction.

4. *The cases.*—*Commissioner* v. *Central Hanover B. & T. Co.*, 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom. Trust of Andrus* v. *Commissioner*, 332 U.S. 830, presented the precise question that is involved in this case in connection with a long-term capital gain realized by an *inter vivos* trust created by the decedent here, which directed the payment of 45 percent of the income, and of the corpus on termination of the trust, to the Surdna Foundation. The Second Circuit, relying on the definitions in Section 117 (a), decided that (p. 210) "the amount of long-term capital gain not taken into account under §117 does not constitute gross income of the trust under §22 (a)." The decision is of course squarely contrary to that of the

Court of Claims in this case[15] and we submit that it reaches the correct conclusion under the statutory provisions, the legislative history, and the approved administrative construction previously discussed.

Also, in *Wellman* v. *Welch*, 99 F. 2d 75 (C.A. 1st), the court stated (p. 76), although no issue with respect to it appears to have been raised, that the estate's *gross taxable income* consisted of interest, dividends, and "capital gain on the sale of capital assets to the extent of 80 percent thereof, $114,790.86." This is a clear recognition that gross income resulted only to the extent the gain was taken into account under Section 117 of the Revenue Act of 1934.

The view that only the capital gain taken into account for tax purposes constitutes gross income is further supported by *Maloy* v. *Commissioner*, 45 B.T.A. 1104. The issue there was whether the entire amount of capital gain constituted gross income within Section 275 (c) of the Revenue Act of 1934, which provides a five year statute of limitations for assessment of a tax if a taxpayer has

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[15] The *Central Hanover* case involved the year 1941. Section 117 (b) of the Code then provided that 50 per cent, 66 2/3 percent, and 100 percent, respectively, of the gain or loss upon sale of capital assets should be taken into account, depending upon whether the capital asset had been held for more than 24 months, for between 18 and 24 months, or for less than 18 months. The different percentages and holding periods, however, do not affect the fact that the same basic question was involved and decided in both cases.

omitted from his return gross income properly includible therein which is in excess of 25 percent of the amount stated in the return. The Board of Tax Appeals, holding that only the capital gain taken into account was gross income, said (p. 1107):

> We agree with petitioner. We think it evident that the term "gross income" as used in section 275 (c), *supra*, refers to the statutory gross income required to be reported on the return. The heading, "Gross Income", on the form of the return calls for the inclusion there only of gross taxable income. That amount does not include that portion of capital gain which is not to be taken into account in computing taxable income, nor does it include non-taxable interest on Government securities. Section 275 (c) refers to the omission from gross income of an amount "properly includible therein", which manifestly does not cover the non-taxable portion of the capital gain realized by the trusts, * * *.

The gross income to be included in the return within the meaning of Section 275 (c) of course corresponds to gross income as defined by Section 22 (a). It has a specific meaning "denoting statutory gross income defined by section 22." *Green v. Commissioner*, 7 T.C. 263, 277. Thus the *Maloy* decision is directly pertinent here, where the issue is whether the part of a capital gain not taken into

account constitutes gross income under Section 22 (a).[16]

In *Green* v. *Commissioner, supra,* the Tax Court held that gross income under Section 275 (c) must be computed without regard to net long-term capital losses; there it was pointed out that Section 23 (g)(1), in providing that such losses must be deducted from gross income to arrive at net income, negates the assumption that such losses are to diminish the gross income which is reportable as such. As already shown, the lack of a corresponding deduction with respect to the capital gain not taken into account can only mean that such gain never becomes part of gross income.

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[16] *Lockhart* v. *Commissioner,* 1 T.C. 804, which the Court of Claims cited, does not necessarily reach an inconsistent result. There the question concerned the amount of gain on satisfaction of unpaid installment obligations. This in turn depended on the basis of the obligation, which Section 44 (d) of the Internal Revenue Code defined as "the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full." The Tax Court held that the income from capital gain which would be returnable, i.e., reportable on the return, was the entire amount of the gain. As already shown, the entire gain is required to be reported on a schedule of the return, but only the specified percentage of the gain to be taken into account is entered as an item of gross income on the return. The Tax Court's decision that the entire gain is "returnaole" must be understood in this setting. The Tax Court was not concerned with the question of whether the entire gain constituted gross income, although some of the statements in the opinion may imply that, in its view, that would be so.

B. Only the taxable portion of a capital gain constitutes "gross income" as that term is used in Section 162(a)

Section 162 (a) of the Internal Revenue Code allows as a deduction "any part of the gross income, without limitation" which is paid or set aside for charitable purposes. Appendix, *infra*, p. 49. Up to this point in the argument, it has been assumed that the term "gross income" as used in Section 162 (a) is synonymous with "gross income" under Section 22 (a). However, there are compelling reasons for construing "gross income" in Section 162 (a) as including only the taxable portion of a capital gain, whether the entire gain or only the part to be taken into account, is regarded as gross income under Section 22 (a).

First, the denial of a deduction under Section 162 (a) with respect to the nontaxable portion of the capital gain set aside for charity would fulfill the Congressional purposes in respect of Sections 161 and 162 as a whole, whereas the decision of the Court of Claims does not. It was Congress' intention that all of the income received by an estate or trust, which is held for, or is distributable to, noncharitable beneficiaries, is to be taxed either to the estate or trust or to the beneficiaries. Under the provisions of Sections 161 and 162 (b) and (c), the income is taxable to the estate or trust if it is not paid or credited and is not currently distributable to the beneficiaries, and the income is taxable to the beneficiaries if currently distributable or properly paid or credited to them, the trust being

entitled to deduct such income. See *Freuler* v. *Helvering*, 291 U.S. 35, 41-42. As was said in *Helvering* v. *Butterworth*, 290 U.S. 365, 369:

> The evident general purpose of the statute was to tax in some way the whole income of all trust estates. If nothing was payable to beneficiaries, the income without deduction was assessable to the fiduciary. But he was entitled to credit for any sum paid to a beneficiary within the intendment of that word, and this amount then became taxable to the beneficiary. Certainly, Congress did not intend any income from a trust should escape taxation unless definitely exempted.

Thus, the 55 percent of the capital gain which will ultimately be distributed to the individual beneficiaries of the testamentary trust in this case was intended to be taxable to the trust since it was not currently distributable and was not distributed. Yet to adopt the decision of the Court of Claims here results in the escape from tax of part of the 55 per cent of the capital gain which is accumulated for ultimate distribution to noncharitable beneficiaries, contrary to the recognized purpose of Sections 161 and 162 (b) and (c). For if the trust is permitted to deduct the entire 45 percent of the capital gain set aside for charity, only one-half of which constituted taxable income, the result is that one-half of the deduction applies, properly, to free the one-half of the charitable gift from tax, while the other half of the deduction ap-

plies to reduce *pro tanto* the taxable one-half of the 55 percent of the gain distributable on termination of the trust to private beneficiaries. Thus, part of the income which was intended to be taxed to the trust escapes tax.[17]

Section 162 (a) was certainly not intended to accomplish this, and thus to frustrate in part Sections 161 and 162 (b) and (c). Its obvious purpose was only to exempt from tax such part of the gross income as was permanently set aside for, or paid to, charity. See *Bowers v. Slocum*, 20 F. 2d 350, 352 (C.A. 2d). That purpose is served when the trust deducts the part of its *taxable* gross income set aside for charity, since it then is not taxable on any part of the charitable gift. And as shown, to enlarge the deduction to cover nontax-

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[17] The precise figures involved are as follows: The trust had income from the long-term capital gain of $60,374.01, of which $27,168.31 was set aside for Surdna Foundation. Only $29,857.41 of the gain (after deducting the loss carry-over) was taxable income to the trust under Section 117 (b). When the entire amount of $27,168.31 set aside for charity is deducted, there remains only $2,689.10 of net income taxable to the trust, despite the fact that of the $29,857.41 gain taken into account in computing income, only $13,435.83 was held for charity and $16,421.58 was held for future distribution to taxable beneficiaries. The trust was clearly intended to be taxed on the $16,421.58 just as clearly as it was not intended to be taxable on the $13,435.83 gift to charity. The decision of the Court of Claims however, through the deduction of $27,168.31 instead of $13,435.83, reduces the trust's income from $16,421.58, to $2,689.10. Thus, $13,732.48 of the income, held for taxable beneficiaries and intended to be taxed to the trust, escapes tax.

able income set aside for charity results in defeating Sections 161 and 162 (b) and (c) in part, since it frees from tax other income intended by those sections to be taxable either to the trust or the beneficiaries. There is certainly no reason to construe Section 162 (a) as giving the trust in this case a windfall of that kind, when the purpose of Section 162 (a) is fully served if all of the taxable capital gain set aside for charity is exempted from tax by way of a deduction. We submit that Section 162 (a) should be construed as permitting a deduction only of the taxable part of a capital gain set aside for charity, in order that Sections 161 and 162 (b) and (c) may operate as they were intended.

That Section 162 (a) should not be construed to authorize a deduction of the nontaxable portion of a capital gain held for charity is also forcefully highlighted by the fact that to do so would permit the equivalent of a double deduction. That is, there would be an exclusion from income under Section 117 (b) of one-half of the gain set aside for charity and then a deduction from taxable income (including that held for distribution to noncharitable beneficiaries) of the entire gain so set aside, including a deduction of the one-half of the gain already excluded from income. It is a well established rule that, in the absence of explicit Congressional authority, double deductions or their equivalent are not to be permitted. *Ilfeld Co. v. Hernandez*, 292 U.S. 62; *McLaughlin v. Pacific*

Lumber Co., 293 U.S. 351; *United States* v. *Ludey*, 274 U.S. 295. The general policy against double benefits through deduction and exclusion of the same item should dictate that Section 162 (a) is to be construed so as to avoid the giving of the equivalent of a double deduction. And especially so, since Section 24 (a)(5) of the Internal Revenue Code (Appendix, *infra*, p. 43) expressly withholds the right in any case to a deduction which is allowable under any other section in so far as it is attributable to income wholly exempt from tax. As Section 29.24-4 of Treasury Regulations 111 (Appendix, *infra*, pp. 50-51) points out, the object of Section 24 (a)(5) is to prevent a double exemption from tax arising through the exclusion of an item from income and a deduction from other income of items allocable to the exempt income. This statutory version of the rule against a double tax benefit through deduction and exemption of the same item admonishes most strongly against a construction of Section 162 (a) which would permit that result.[18]

Even if the matter were less clear than we believe it to be, the principle that a provision exempt-

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[18] Section 24 (a)(5) is merely one example, expressed in general terms, of the Congressional policy not to allow deductions for amounts allocable or attributable to exempt or nontaxable income. See, e.g., Sections 125 (a)(2), 211 (c)(2), 213 (a) and (c), 232 (a), and 251 (e) of the Internal Revenue Code. The consistent policy in this respect plainly fortifies the correctness of our position here.

ing income devoted to charity is not to be narrowly construed (*Helvering* v. *Bliss,* 293 U. S. 144, 150-151; *United States* v. *Pleasants,* 305 U. S. 357, 363)[10] does not in the circumstances here support a construction of Section 162 (a), which would allow a deduction for the entire capital gain set aside for charity. The object of granting the deduction for charitable gifts under Section 162 (a) was obviously to encourage such gifts by exempting the income given to charity from tax. *Helvering* v. *Bliss, supra,* pp. 150-151; *Bowers* v. *Slocum,* 20 F. 2d 350, 352 (C.A. 2d). As already shown, this purpose is served when half the long-term capital gain is excluded from gross income and deduction is had for the other half—the taxable income given to charity. In this way, at the same time, the purpose of Sections 161 and 162 (b) and (c) to tax the income held for other beneficiaries is also fulfilled. A broader construction, that is, the allowance of a larger deduction than is necessary to accomplish the purpose of exempting charitable gifts from tax is certainly not warranted, especially where to do so will frustrate the operation of other sections and will result in allowing the taxpayer the equivalent of a double deduction. Such considerations were not present in the

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[10] The *Bliss* and *Pleasants* cases were concerned with the amount of the deduction for charitable contributions under predecessors of the present Section 23 (o). The statutory provisions relating to capital gains and losses which they considered were materially different from those involved here.

Bliss and *Pleasants* cases. In this connection, cf. *Taft* v. *Commissioner*, 304 U.S. 351, 359, and *Harrison* v. *Northern Trust Co.*, 317 U.S. 476, 480-481, which indicate that the principle of a broad construction, as applied to deductions for gifts to charity, is not without limitation. It may be observed here that Section 162 (a), of course, does not grant an unlimited deduction for all gifts to charity, since gifts of corpus are excluded by its terms. The deduction is for the purpose of ascertaining a trust's taxable net income and because of this it seems necessary to impute an intention to exclude items which do not enter into taxable income.

C. The taxpayer's allowable deduction under Section 162(a) is 45 per cent of the taxable portion of the capital gain

We have sought to show that only 50 per cent of the capital gain of the trust in this case constituted gross income under Section 22 (a) or, in any event, within the meaning of that term as used in Section 162 (a). If either of these arguments is accepted, it follows that the trust's deduction under Section 162 (a), which grants a deduction for only such part of the gross income as is permanently set aside for charity, is 45 per cent of the 50 per cent of the gain (less the loss carry-over), which is gross income, or $13,435.83. See *Commissioner* v. *Central Hanover B. & T. Co.*, 163 F. 2d 208 (C.A. 2d), certiorari denied, *sub nom.* *Trust of Andrus* v. *Com-*

missioner, 332 U. S. 830, which decided that the deduction under Section 162 (a) must be limited to the part of the charitable gift made out of statutory gross income.

The Court of Claims in this case rejected the conclusion set forth above on the ground that it resulted in allowing the taxpayer a deduction under Section 162 (a) of only the "net income", instead of the gross income, set aside for charity. (R. 9, 11.) This view, of course, is not accurate if only the capital gain taken into account constitutes gross income, since the deduction of $13,435.83 to which the taxpayer is concededly entitled would be a deduction for all of the gift to charity which came from "gross income."

Nor does the position of the Government fail to give effect to the language "gross income, without limitation" used in Section 162 (a). If only the gain taken into account constitutes gross income, the taxpayer will be allowed a deduction for the full amount of such gain set aside for charity and thus of its entire gross income so set aside without limitation.

In any case, it seems clear that the words "without limitation" have the purpose only of removing for estates and trusts the 15 per cent of net income limitation imposed by Section 23 (o) of the Code (Appendix, *infra,* pp. 41-42) on the deduction by individuals of charitable contributions. *Commissioner* v. *Central Hanover B. & T. Co., supra,* p.

211; *Grey* v. *Commissioner,* 41 B.T.A. 234, 243, affirmed, 118 F. 2d 153 (C.A. 7th), and *Scott* v. *United States,* 78 F. Supp. 811, 815-816 (C. Cls.), so held. As was pointed out in *Grey* v. *Commissioner,* p. 243, this is obvious from the parenthetical matter in Section 162 (a) (Appendix, *infra,* p. 49) that the deduction is in lieu of that allowed by Section 23 (o).

The legislative history of the phrase "without limitation" moreover, supports this view.

In the Revenue Act of 1913, c. 16, 38 Stat. 166, and the Revenue Act of 1916, c. 463, 39 Stat. 756, there was no provision for the deduction by individuals of gifts to charities in computing their net incomes, nor was there any exemption or deduction in favor of income accumulated in a trust fund which was not to be distributed annually or regularly even though such income was to go ultimately to a charity. Section 1201(2) of the Act of October 3, 1917, c. 63, 40 Stat. 300, amended the Revenue Act of 1916 by adding a provision for the deduction by individuals of charitable contributions to an amount not in excess of 15 percent of the taxpayer's taxable net income. In paragraph (11) of Section 214(a) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, the provision was continued for the deduction of charitable gifts by individuals up to 15 percent of their total net incomes. Subdivision (a) of Section 219 of that Act imposed upon the income of trust estates and income held for fu-

ture distribution under the terms of a will or trust, the same taxes which the Act imposed upon the income of individuals, and subdivision (b) of Section 219 provided:

> The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that there shall also be allowed as a deduction (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of Section 214) any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for * * * any corporation organized and operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the earnings of which inures to the benefit of any private stockholder or individual; * * *

The words "without limitation" first appeared in Section 219(b) of the Revenue Act of 1921, c. 136, 42 Stat. 227, which provided—

> * * * The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of Section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside

> for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. * * *

This change, together with other changes in the 1921 Act, had been embraced within Section 225 of the House Bill and the changes were explained in H. Rep. No. 350, 67th Cong., 1st Sess., p. 12 (1939-1 Cum. Bull. (Part 2) 177) as follows:

> Section 225 removes certain obscurities in existing law relating to the income of estates or property held in trust by explicitly adopting the construction which has uniformly been given to this section of the law by the Treasury Department.

The provision in question was included in Section 219 of the bill as reported to the Senate, and was explained in S. Rep. No. 275, 67th Cong., 1st Sess., p. 16 (1939-1 Cum. Bull. (Part 2) 192) as follows:

> Section 219 is amended slightly for the purpose of clarifying its provisions and making the interpretation thereof more definite and certain.

It is apparent, we submit, that the only plausible explanation for the insertion of the words "without limitation" was to make certain that the deduction given to trusts in lieu of the deduction allowed individuals for charitable contributions was to be without the 15 percent limitation which applied to charitable gifts by individuals.

In Section 219(b) of the Revenue Act of 1924, c. 234, 43 Stat. 253, the parenthetical language "(in lieu of the deduction authorized by paragraph (10) [paragraph (11) of the Revenue Act of 1921] of subdivision (a) of section 214)" was shifted to follow the word "deduction" and the phrase "without limitation" was shifted to follow the words "gross income" instead of following the word "deduction". The statute has continued in that form in all subsequent acts. This change in the position of the words "without limitation" was apparently not regarded as having any significance since it was not discussed in the committee reports. H. Rep. No. 179, 68th Cong., 1st Sess., p. 21 (1939-1 Cum. Bull. (Part 2) 241, 256); S. Rep. No. 398, 68th Cong., 1st Sess., p. 25 (1939-1 Cum. Bull. (Part 2) 266, 283.) See *Grey* v. *Commissioner*, *supra*, p. 243. Cf. *Old Colony Co.* v. *Commissioner*, 301 U.S. 379, 382-383.

Under the view here advanced, the taxpayer is given the full benefit by way of deduction of the entire part of the gain set aside for charity. This results from the exclusion from gross income of one-half of the charitable gift under Section 117 (b) and the deduction under Section 162 (a) of the other half of the charitable gift. The allowance of a deduction of one-half of the portion of the gain set aside for charity is, we believe, the correct deduction under the statutory provisions discussed above, since only one-half of the gain constitutes gross income.

CONCLUSION

The judgment of the Court of Claims should be reversed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
LEE A. JACKSON,
HELEN GOODNER,
Special Assistants to the Attorney General.

September, 1949.

Internal Revenue Code:

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

* * * * * *

(26 U.S.C. 21.)

SEC. 22. GROSS INCOME.

(a) [As amended by the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574, Sec. 1] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions From Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * *

(f) *Determination Of Gain Or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

* * * * * *

(26 U.S.C. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

* * * * * *

(o) [As amended by the Revenue Act of 1939, c. 247, 53 Stat. 862, Sec. 224 (a), and the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 127 (c)] *Charitable and Other Contributions.*—In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) The United States, any State, Territory, or any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes;

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private share-

holder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) the special fund for vocational rehabilitation authorized by section 12 of the World War Veterans' Act, 1924, 43 Stat. 611 (U.S.C., Title 38, §440);

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a domestic fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection or of subsection (x). Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * * *

(26 U.S.C. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * * *

(5) [As amended by the Revenue Act of 1942, *supra,* Sec. 121(b)] Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this chapter or any amount otherwise allowable under section 23 (a)(2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter.

* * * * * *

(26 U.S.C. 24.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation Of Gain Or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * * *

(c) *Recognition Of Gain Or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be rec-

ognized for the purposes of this chapter, shall be determined under the provisions of section 112.

* * * * * *

(26 U.S.C. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * * *

(26 U.S.C. 112.)

SEC. 116. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * *

(26 U.S.C. 116.)

SEC. 117 [As amended by the Revenue Act of 1942, *supra*, Sec. 150]. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

* * * * * *

(2) *Short-term Capital Gain.*—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(3) *Short-term Capital Loss.*—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

(4) *Long-term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

(5) *Long-term Capital Loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;

(6) *Net Short-term Capital Gain.*—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year;

(7) *Net Short-term Capital Loss.*—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) *Net Long-term Capital Gain.*—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) *Net Long-term Capital Loss.*—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year;

(10) *Net Capital Gain.*—

* * * * * *

(B) *Other Taxpayers.*—In the case of a taxpayer other than a corporation, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from such sales or exchanges. For purposes of this subparagraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

* * * * * *

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

(c) *Alternative Taxes.*—

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(2) *Other Taxpayers.*—If f~~or any tax~~able year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 50 per centum of such excess.

* * * * * *

(e) *Capital Loss Carry-over.*—

(1) *Method of computation.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. For purposes of this paragraph a net capital gain shall be computed without regard to such net capital loss or to any net capital losses arising in any such intervening taxable years.

(2) *Rule for application of capital loss carry-over from 1941.*—The amount of the net short-term capital loss of the last taxable year beginning in 1941 (computed without regard to amounts treated as short-term capital losses from the preceding taxable year), which is not in excess of the net income for such taxable year, shall, to the extent of the net short-term capital gain for the succeeding taxable year (computed without regard to this paragraph), be a short-term capital loss of such succeeding taxable year.

* * * * * *

(26 U.S.C. 117.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application Of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

* * * * * *

(b) *Computation And Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

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(26 U.S.C. 161.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) [As amended by the Revenue Act of 1942, *supra*, Sec. 111 (b)] There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administra-

tion or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary;

*   *   *   *   *   *

(26 U.S.C. 162.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.24-4. *Amounts Allocable to Exempt Income, Other Than Interest.*—(*a*) *Class of exempt income.*—As used in this section, the term "class of exempt income" means any class of income, including interest only to the extent that amounts otherwise allowable under section 23 (a)(2) are allocable thereto (whether or not any amount of income of that class or classes is received or accrued), wholly exempt from the taxes imposed by chapter 1. Included are any item or class of income, including interest only to the extent that amounts otherwise allowable under section 23 (a)(2) are allocable thereto, constitutionally exempt from the taxes imposed by chapter 1; any item or class, as above defined, excluded from gross income under any provision of section 22 or section 116; and any item or class of income, as above defined, exempt under the provisions of any

other law from the taxes imposed by chapter 1. The term "taxable income" as used in this section means income which is required to be included in gross income; and the term "exempt income" means income which is not required to be included in gross income.

The object of section 24 (a)(5) is to segregate the exempt income from the taxable income, in order that a double exemption may not be obtained through the reduction of taxable income by expenses and other items incurred in the production of items of income wholly exempt from tax. Accordingly, just as exempt items of income are excluded from the computation of gross income under section 22, so section 24 (a)(5) excludes from the computation of deductions under section 23 all items referable to the production of exempt income, as above defined.

*   *   *   *   *   *

SEC. 29.117-2. *Percentage Of Capital Gain Or Loss Taken Into Account: Net Loss Carry-Over.*—(*a*) *General.*—In computing the net income of a taxpayer, other than a corporation, the amount of the gain or loss, computed under section 111 and recognized under section 112, upon the sale or exchange of a capital asset shall be taken into account only to the extent provided in section 117 (b). The percentage of the gain or loss to be taken into account ranges from 100 percent to 50 percent, depending upon the period for which the asset was held. For instance, if unimproved real estate purchased by an individual for $20,000 is a capital asset and is sold by him for $25,000 after having been held for more than six

months, only 50 percent of the recognized gain ($5,000), or $2,500, shall be taken into account in computing net income; or if such property is sold for $14,000, only 50 percent of the recognized loss ($6,000), or $3,000, shall be so taken into account.

* * * * * *

Sec. 29.162-1. *Income Of Estates And Trusts.*— * * *

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

(*a*) Any part of the gross income of the estate or trust for its taxable year which, by the terms of the will or of the instrument creating the trust, is paid or permanently set aside during such year for the charitable, etc., uses or purposes referred to or described in section 162 (a). This deduction is in lieu of that authorized by section 23 (o) in the case of individual taxpayers.

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